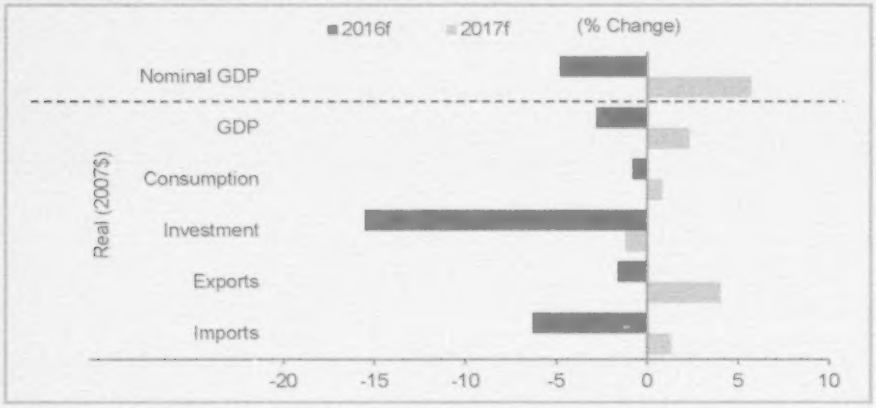
Economic Trends

This edition of Trends is taken from the Second Quarter Fiscal Update and Economic Statement, released on November 28, 2016.

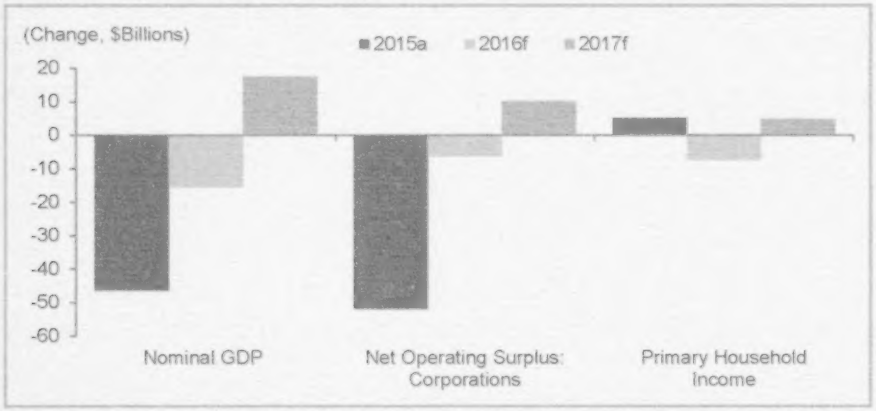
The economy is showing signs of stabilizing more than two years after oil prices began their descent. Many major economic indicators are leveling off and business output is slowly improving. This improvement is expected to carry into 2017, leading to a modest recovery. Real GDP is forecast to increase by 2.3% (Chart 1), slightly lower than at the *First Quarter Update*, but higher than the 1.9% expected at *Budget*. The recovery will be bolstered by an uplift in oil prices, ongoing public sector infrastructure spending, Fort McMurray reconstruction and an associated rebound in oil production.

Chart 1: Modest recovery anticipated for 2017
Percentage change in select economic indicators



Source: Alberta Treasury Board and Finance, f-forecast

Chart 2: Falling incomes weigh on nominal GDP
Components of Alberta nominal GDP



Sources: Statistics Canada and Alberta Treasury Board and Finance, f-forecast, a-actuals

The downturn, however, has been deeper than previously expected. After falling 3.6% in 2015, real GDP is forecast to decline 2.8% in 2016, reflecting weaker activity so far this year and wildfire-related disruptions. This is a larger contraction than the 1.4% forecast at *Budget*.

Incomes in the province have been significantly impacted during the downturn. Nominal GDP, a broad measure of income, is forecast to fall an estimated 4.8% this year after declining 12.5% in 2015. Corporate profits have taken the largest hit (Chart 2), but government revenue and household income have also dropped. In 2017, nominal GDP is forecast to expand by 5.7% but will remain below 2014 levels.

External risks have increased. Global economic growth continues to underwhelm, while events such as Brexit, the outcome of the election in the United States and turbulence in European financial markets have heightened uncertainty.

Alberta Business Sector

Muted outlook for energy prices

Prospects of an output cut by the Organization of the Petroleum Exporting Countries (OPEC), oil supply disruptions and declines in US crude output have supported oil prices so far this year. Global oil market rebalancing has started, but crude inventories remain high. Uncertainty about demand and the timing of market rebalancing, which has moved further into 2017, are contributing to ongoing volatility in oil prices. The forecast for West Texas Intermediate is US$45/bbl for 2016-17, US$3/bbl higher than *Budget*, mainly due to year-to-date strength.

The outlook for natural gas prices remains soft as the North American market continues to be awash in natural gas. The Alberta Reference

Price is expected to average Cdn$2.10/GJ, lower than the *Budget* forecast of Cdn$2.40/GJ.

Investment drags on growth

The severe oil price shock and ongoing volatility in oil prices have weakened energy investment, which is expected to be about half of 2014 levels in 2016. However, drilling activity has picked up in the last five months, and spending on sustaining capital will continue to support oil sands investment in 2017. Outside the energy sector, investment continues to be hampered by declining commercial and industrial spending. Building permits suggest weakness will continue into 2017 as current projects wind down. This will be partly offset by strong levels of government and institutional spending. After a decline of 23% in 2015, business investment is now forecast to recede by over 16% in 2016 and hold fairly steady in 2017.

Business output improving

After declining for much of the past two years, there are signs that business activity is starting to stabilize (Chart 3). Bitumen production appears to have recovered after outages from the wildfire and is up 6% in the first eight months of this year. Manufacturing shipments have improved since falling to a low in February, supported by refined petroleum products, chemicals, and wood products. Declines are also easing in machinery and equipment manufacturing, which suffered the most from the slowdown in energy-related activity across North America. Heading into 2017, manufacturing output is expected to pick up, supported by expansions in petroleum manufacturing and petrochemicals. Overall, weaker-than-expected manufacturing combined with fire-related disruptions in oil production are expected to pull down Alberta's real exports by 1.6% this year. Real exports are expected to recover by 4% in 2017.

Corporate profits take a hit

The plunge in oil prices and slowdown in activity in the province have resulted in an unprecedented decline in corporate profits. After falling 69% in 2015, net operating surplus, a measure of profits, is expected to fall an additional 27% this year. As business output and oil prices improve in 2017, net operating surplus is expected to expand by around 60% but remain about a third of 2014 levels.

Alberta Household Sector

Solid population growth

Alberta's population continues to expand due to record-setting immigration and substantial natural increase. In addition, annual net outflows of interprovincial migrants for the 2016 census year were about half the level forecasted at *Budget*. Overall, 2016 census year population growth was 1.8%, leading all provinces and higher than the 1.2% *Budget* forecast. Downward revisions to population in the previous four years mean Alberta's population estimate is fairly closely to *Budget*. Growth is forecast to slow to 1.3% in 2017, led by a net outflow of 11,000 interprovincial migrants, in line with the forecast at *Budget*.

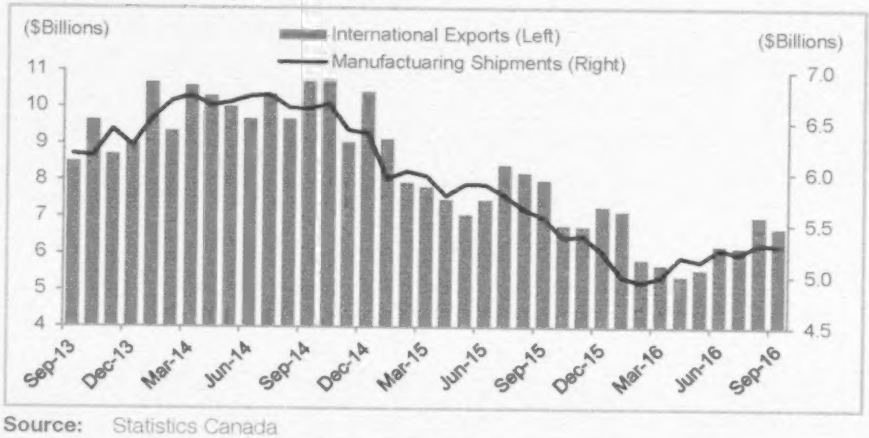
Employment edges higher

The labour market continues to evolve as expected at *Budget*. As the downturn became more broadly based, Alberta's labour market deteriorated in the first half of 2016. Employment fell nearly 38,000 between December 2015 and July 2016, with job losses mounting in the second quarter. As a result, employment is forecast to decline 1.7% this year. More recently though, employment has started to improve. There were 25,000 jobs added between July and October (Chart 4), with almost all of the gains in the private sector. Employment is expected to continue improving in 2017 and expand by 1.2%. Despite the increase in jobs, the unemployment rate remains elevated as more people continue to look for work. The rate currently sits at 8.5% and is expected to remain above 8% for the remainder of this year. It is forecast to move down to an average of 7.8% in 2017.

Pullback in earnings

Though Alberta still has the highest hourly wage rate among the provinces, sustained economic weakness has dragged down total earnings. Reductions in overtime, declining full-time employment, and gains in part-time employment are expected to pull down average weekly hours worked by over 2% this year. As a result, average weekly earnings are expected to fall by 2.6% in 2016, a deeper contraction than projected in *Budget*. A small rebound in earnings is forecast for 2017, but growth will remain well below average earnings growth realized prior

Chart 3: Exports and manufacturing shipments improving
Alberta business output indicators



Source: Statistics Canada

to the recession. The drop in total earnings has cut primary household income by 3.5% in 2016. Growth will improve to 2.4% in 2017.

Consumers rein in spending

The weak labour market and lower earnings are forcing consumers to reduce spending. Through nine months of the year, retail sales have declined over 2%, with broad-based weakness across most categories. Spending on durables has been hit particularly hard as consumers curtail spending on non-essential items. Adjusted for inflation, real consumer spending is expected to decline almost 1% this year before picking up next year as employment and earnings recover.

Housing activity remains weak

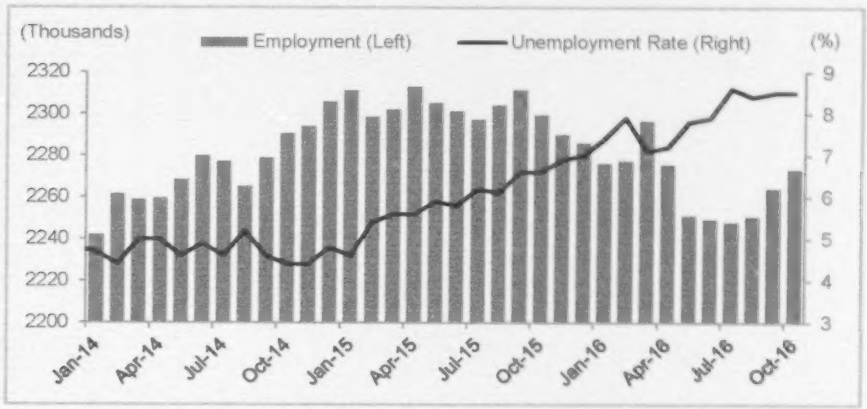
Weaker housing demand is weighing on residential activity in the province, but the sector is exhibiting some signs of stability. The number of housing starts and sales of existing homes remain well below pre-recession levels, while vacancy rates have gone up. However, starts and existing home sales have improved in recent months. Housing starts have been revised up slightly from *Budget* to 24,000 to reflect stronger year-to-date activity. In 2017, they are forecast to be higher-than-expected compared with *Budget*, partly due to reconstruction activity in Fort McMurray.

Costs coming down

Costs in the province are moderating for businesses and consumers (Chart 5). Slower economic activity and falling labour costs have resulted in lower construction costs. Building construction costs have declined by around 3.5% since the beginning of 2015. For consumers, lower energy prices and easing shelter costs are keeping a lid on inflation. In addition, prices have declined for most discretionary consumer goods. Inflation is expected to be a muted 1.2% in 2016, lower than the 1.5% forecast at *Budget*, before picking up to 1.9% in 2017.

Chart 4: Employment showing encouraging signs

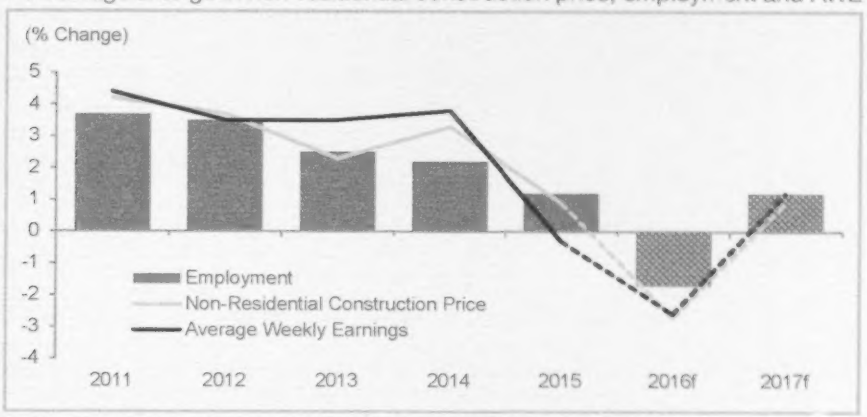
Alberta labour market indicators



Sources: Statistics Canada

Chart 5: Cost pressures easing

Percentage change in non-residential construction price, employment and AWE



Sources: Statistics Canada and Alberta Treasury Board and Finance. f-forecast

Risks to the Outlook

Risks to the Alberta economy remain elevated, reflecting uncertainty about the path of oil prices and global economic conditions:

- Weaker-than-expected global growth could dampen demand for oil, lowering oil prices. Should prices fall further, Alberta's outlook would weaken.
- If OPEC fails to reach an agreement to freeze output and oil inventories remain high, especially in the US, this could delay rebalancing of oil markets. This delay could slow Alberta's economic recovery.
- A slower-than-expected improvement in business activity in the province will dampen prospects for employment and earnings.
- On the positive side, higher than expected growth in the US or easing pipeline constraints can improve Alberta's economic prospects.

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